

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

FRANK and BETTY WATKINS,
Debtors.

Case No. 98-55281-JRG

Chapter 7

**ORDER DENYING MOTION BROUGHT
BY CREDITOR, RICK WADE, TO SET
ASIDE ORDER APPROVING
COMPROMISE PURSUANT TO F.R.C.P.
60(B)**

On February 18, 1999, Chapter 7 Trustee, Mohammed Poonja ("Trustee"), filed a "Notice of Trustee's Intention to Compromise Estate's Interest in Property of the Estate." In his notice, the Trustee stated that he had entered into a settlement agreement with the debtors, Frank and Betty Watkins, in which the Trustee would accept the sum of \$40,000 in full satisfaction of the estate's claims against the debtors' assets; of this amount, \$20,000 "represented the agreed-upon equity in the residence." [Trustee's Compromise at line 4, p.2.] The Trustee believed that this settlement was in the best interest of the estate and would create the best possible return to creditors. On March 15, 1999, the court signed the order "Authorizing the Trustee to Compromise Estate's Interest in Property of the Estate."

The Trustee's assessment of the assets was well supported. While the Trustee thought there might be some excess equity in the debtors' residence, it may well be that there was, in fact, no excess equity. Although the precise amount of the liens on the residence are in some dispute, all of the figures set forth in various pleadings indicate there exists the following liens on the property together with the debtor's homestead exemption:

Lien	Approximate Lien Amount
Beneficial Deed of Trust	\$305,000
Bank of America Deed of Trust	\$5,000
IRS Lien	\$94,505
Homestead Exemption	\$125,000
Wade Judicial Lien	\$427,632 ¹
Total	\$957,137

Based on the above, it appears that the liens on the property together with the debtors' homestead total \$957,137.² Estimated values for the property have ranged from \$750,000 to \$900,000, although it is not clear whether these values are as of the petition date or at some later time. In addition, if the Trustee were in a position to compel a sale of the property, it is assumed that he would incur a six to eight percent cost of sale. Eight percent of \$957,137 is \$76,571. For the estate to receive any benefit the sales price would therefore have to exceed \$1,033,708.³ There is no indication of such a value at the time the debtors filed bankruptcy.

As indicated, the Trustee's compromise was approved March 15, 1999. Two months later, on May 25, 1999, lien creditor Rick Wade filed a motion seeking to set aside the Trustee's compromise. His motion rested on the theory that the Internal Revenue Service mislead the debtors and Wade regarding the amount of its lien on the residence. Although the I.R.S. filed a secured claim with the court on January 25, 1999 in the amount of \$94,505.60, Wade claimed that he was told the I.R.S. claim was going to be amended and that the actual lien amount would turn out to approximate \$300,000 to \$350,000. Wade argued that had he known the I.R.S. lien would only be \$94,505.60, he would have objected to the compromise.

Strangely, the Trustee joined in Wade's motion to set aside his own compromise. It is strange because from the Trustee's standpoint, the amount of the I.R.S. lien was irrelevant. Since the property was

¹ With interest, this amount is claimed to be over \$500,000.

² There are two additional claims for \$40,000 and \$82,000 but it is not clear whether they are liens on the debtors' residence.

³ To what extent a sale will generate capital gains tax against the estate is unknown to the court.

1 over-encumbered when the I.R.S. lien was \$94,505.60, the Trustee's position would be no different if the
2 lien increased. It also appears the Trustee was aware of the correct amount of the I.R.S. lien at the time he
3 entered into the compromise.

4 Wade's purpose in setting aside the compromise is to allow a sale of the residence. Both Wade
5 and the Trustee indicated that a sale of the debtors' residence could be conducted in the future. Since the
6 Trustee appeared to have no interest in the property at the time of the filing, the question naturally arises as
7 to how the trustee could compel a sale from a legal point of view. The court requested an explanation but
8 no authority for this point has been provided.⁴

9 Setting aside the legal question, the factual basis for the Trustee's desire to now sell the residence is
10 a proposal Wade made to the Trustee after the compromise had been approved. On April 20, 1999,
11 Wade sent a letter to Trustee's counsel outlining a proposed deal. Wade proposed that following a sale he
12 would receive "ninety percent of net proceeds of sale after paying all senior liens and administrative costs of
13 the case. The other ten percent could be available for general unsecured creditors. However, Mr. Wade
14 would be entitled to retain the balance of his claim as a general unsecured claim against the estate." [Exhibit
15 "C" to Declaration of Barry Milgrom.]

16 Assuming Wade legally could get the Trustee to sell the residence, he avoids whatever problems
17 might exist in attempting to enforce his lien in state court pursuant to the provisions of the California Civil
18 Code. While the amount of the I.R.S. lien had no effect on the position of the Trustee, it apparently had an
19 effect on Wade. Wade argues that had he known the I.R.S. lien would not be increased above
20 \$94,505.60, he would have approached the Trustee earlier with his offer to pay a fee in return for selling
21 the over-encumbered property.

22 Wade's proposal raises a number of concerns, none of which have been adequately addressed.
23 As previously mentioned, the court wonders how a Trustee can legally compel the sale of an over-
24 encumbered piece of real property. Secondly, Wade's proposal makes no provision for the payment of
25 priority claims. The case was designated as a "no asset" case, meaning that claims were not requested. As
26

27 ⁴ The court requested the Trustee to respond to the following question. On what basis could the Trustee compel a sale of this
28 over-encumbered property? The Trustee failed to provide relevant authority to force the sale of an over-encumbered property.

1 such, we do not presently know what claims may be filed by creditors or by the debtors pursuant to
2 Bankruptcy Rule 3004.⁵ Thirdly, we do not presently know the extent of Wade's lien on the debtors'
3 residence. The debtors filed a motion under § 522(f) to avoid Wade's lien which has not yet been ruled
4 upon. If Wade's proposed sale would pay him more than his allowed secured claim, then the proposal
5 would be changing the priorities of the Bankruptcy Code. Until the § 522(f) motion is resolved, we do not
6 know what Wade is entitled to in a sale of the property. Lastly, from a policy point of view, when a piece
7 of real property is simply over-encumbered should not the relationship between debtor and secured
8 creditor be left for determination under state law?

9 For the reasons stated above, Rick Wade's motion to set aside the compromise pursuant to
10 F.R.C.P. 60(b) is denied.

27 ⁵ The debtors scheduled the claim of the I.R.S. as "unknown" and a tax claim in favor of the California Franchise Tax Board
28 in the amount of \$84,000. These claims were scheduled as unsecured which may, or may not, turn out to be their true nature.